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SUBJECT: Turkish Markets Unfazed by Middle East Crisis, but Tourism Sector Worried

Ref: Ankara 1568

This cable was coordinated with Congen Istanbul.

1.(SBU) Summary: The Middle East crisis has yet to have a significant impact on the Turkish Economy though some business people worry it could if it persists or broadens to other countries. After falling as the Israeli-Hezbollah fighting began, Turkish markets have recovered and even rallied along with other Emerging Markets. Lebanon is only a minor trading partner; however there are early signs of a fall in tourists from Lebanon and possibly other countries. The biggest economic impact derives from the conflict's effect on world oil prices, and Turkish business people worry more about Iran- and Iraq-related developments. End Summary.

Turkish Markets Not Focused on Middle East crisis:

12. (SBU) The crisis in the Middle East has not been a significant factor in Turkish financial markets over the past two weeks. Although Turkish markets fell in line with other Emerging Markets (EM) immediately after Israel began its military action in Lebanon July 12, Turkey's geographic proximity did not cause Turkish markets to be hit harder than other EM. Over the week of July 24-30, in the absence of negative domestic news, and with portfolio investors regaining their appetite for Emerging Market securities, Turkish markets have been gradually strengthening with the exchange rate appreciating to a two-month high of 1.49 per dollar on July 27. Market analysts are barely mentioning the Israeli-Lebanese conflict in their newsletters.

Minor Trade Relationship, but Worries about Tourism

13. (SBU) Turkey conducts only a modest level of trade with Lebanon: \$345 million in two-way trade of which \$196 million are exports. Compared to Turkey's total exports of \$ 76 billion in 2005, sales to Lebanon are of negligible importance. Turkey has a much bigger trading relationship with Israel with \$1.46 billion in exports in 2005 but these sales are likely to continue despite the conflict. Turkish-Lebanon Business Council Co-chairman Mehmet Habbab said 150,000 Lebanese tourists come to Turkey in a year. If the crisis causes these numbers to dry up, it could exacerbate the already down year the Turkish tourism sector is experiencing but this is not a disaster. The Chairman of the Turkish Hotel Federation was quoted in the press July 28 saying that not only Lebanese tourist arrivals but also arrivals from neighboring countries such as Jordan have already stopped. He said Turkey will miss out on the developing tourist potential from the Middle East. With regard to the major source countries for Turkish tourism, however, there are no signs

yet that the proximity of the conflict is causing other tourists to cancel trips to Turkey. The owner of a hotel in the Mediterranean resort of Gocek who caters to British tourists did not even mention the Middle Eastern situation in an extended conversation about this year's season on July 23.

Businessmen Calm About Short-term but Some Worry

4.(SBU) At a recent dinner in Istanbul with executives for U.S. companies in Turkey, none seemed concerned about the conflict's impact on their bottom line. The Ankara representative of TUSIAD, the Turkish Industrialists' Association, said TUSIAD was not concerned about any immediate short-term impact, nor was a leading Istanbul market analysts we spoke to. The US company executives were quite concerned on the other hand, about the plight of Lebanese civilians, including employees of their groups. In general, our business contacts, like most Turks, feel for the Lebanese civilians caught in the fighting and believe the Israeli actions to have been disproportionate (reftel).

5.(SBU) Some business contacts expressed the concern that, if the conflict persists or broadens to other countries it could come to have a negative impact on the economy of many eastern Mediterranean countries. The Union of Mediterranean Business Confederations, of which TUSIAD is currently president, put out a statement July 25 expressing this concern. The Chairman of the Union of Turkish Chambers of Commerce, TOBB, pointed out that the "Ankara Forum," a TOBB-led initiative to develop ties between Israeli and Palestinian chambers of commerce would have had its fourth meeting had it not been for the current conflict. TOBB also told us that its project to revive the Erez Industrial Zone in Gaza has taken a huge step backwards because the recent fighting badly damaged the

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previously-intact Industrial Zone. Some Turkish business contacts also noted the danger that the AKP Government's penchant to care more about developments in the Muslim world than other Turkish Governments, holds the potential to create either domestic political frictions or frictions with the western world, either of which can add to financial market nervousness.

Oil Price Always a Concern

6.(SBU) With Turkey importing over 90% of its petroleum, high oil prices have been a major factor in the growth of Turkey's current account deficit in 2005 and so far in 2006. The IMF estimates that Turkey's oil imports will total \$23 billion in 2003, roughly equivalent to the expected size of the current account deficit. Though Middle East tensions are one of many factors in high oil prices, the surge in prices on the news of the Israeli movement into Lebanon exacerbates the outlook for a continued large current account deficit in Turkey, and higher oil prices, if they persist, are likely to exacerbate the slowdown in growth in the second half of 2006 that is now expected as a result of the May-June fall in the exchange rate and higher interest rates. But few analysts expect the high oil prices to be a bigger problem for Turkey than it already is, unless prices surge higher than current levels.

Bigger Impact if Conflict Broadens

17. (SBU) If the current conflict broadens or exacerbates instability in other Middle Eastern countries, particularly Iran or Iraq, that would be a far bigger concern for the Turkish economy. Although Turkey signed a free trade agreement with Syria, Turkey's exports to Syria were only \$495 million in 2005. By contrast, Iran- and Iraq-related developments worry Turkish business people and market analysts. Not only do Iran and Iraq have a much bigger effect on oil markets, but they are larger trading partners and both are viewed as important to the Turkish economy. Iraq was Turkey's largest trading partner prior to 1991 and Turkey exported \$2.4

billion to Iraq in 2005. Turkey exported \$820 million to Iran in 2005 and imported \$3.2 billion, mostly natural gas. An MFA official also told us Turkey sees Iran as a vital gateway for trade with Central Asia since most of this trade is trucked through Iran. The prospect of possible UN sanctions on Iran, therefore, causes Turks to fear a repeat of the perceived damage to their economy from the UN sanctions on Iraq.

McEldowney